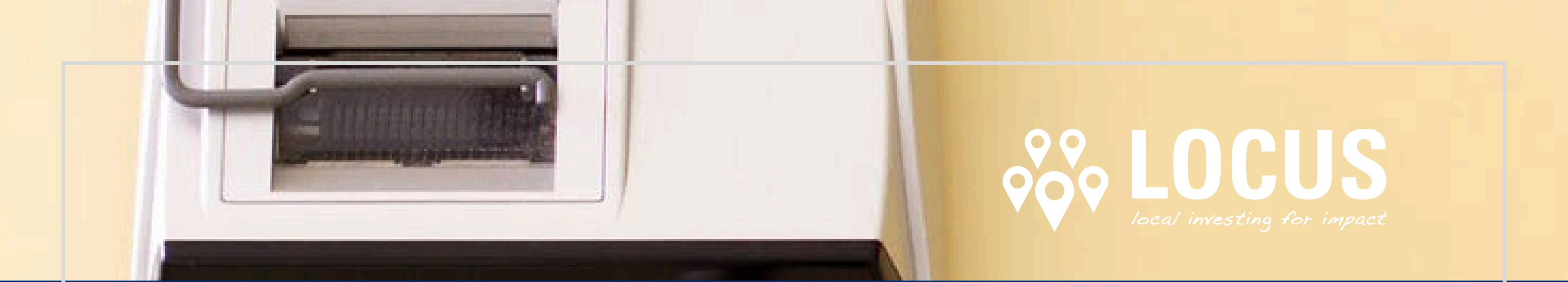

Local Investing for Impact

Resourcing Local Impact Investing: Examining How Community Foundations Marshal Resources for Local Impact Investing Programs

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Previously, community foundations wishing to achieve greater impact had just two strategies: grow total assets or expand grantmaking and community leadership. Excitingly, local impact investing gives foundations a new way to make a difference. This new tool, though, complicates the traditional community philanthropy business model. A leading concern for boards is balancing the potential for greater impact with additional costs and staff time required to build a successful program. Motivations aside, launching a local impact investing program is a staff-intensive undertaking that requires the attention of leadership, new professional services, new operations and processes, and new committees and volunteers.

Unfortunately, the relative newness of local impact investing programs and their contrasting approaches means there is limited information about what is required to resource these strategies. LOCUS facilitated a community foundation discussion on program operations and collected survey responses from nine community foundations *(Table 3)* with local portfolios ranging from $2 million to $24 million. With this new data and greater information about what local impact investing entails, we hope community foundations can overcome the anxieties, misperceptions and reservations that inhibit organizations from taking bolder steps towards investing more resources into communities. Ultimately, we believe that knowledge-sharing around local impact investing will grow the field, improve the practice by community foundations, and accelerate the deployment of more capital into communities. Although the following observations are based on a limited dataset, we hope to grow our knowledgebase over time through an expanding network of practitioners.

Understanding Possible Expenses

Local impact investing and grantmaking involve many similar actions and activities – setting strategy, networking in community to source opportunities, evaluating opportunities for mission alignment, monitoring programs, and reporting on performance. In an investment context, however, these functions require a different skill set that often prompts foundations to hire new staff, recruit specialized volunteers, or contract professional services.

Some examples of local impact investing skills and services sought by foundations include:

→ **Training and education**
Before launching local impact investing programs, many foundations provide education and training for staff and board. Education sometimes entails exploration of the local capital ecosystem and partners. Occasionally foundations will meet with peers that have implemented programs and inquire about elements of program design. Finally, some foundations will design staff and board onboarding processes that introduce new team members to local impact investing practice, investment strategies, and emerging notions of fiduciary duty.

→ **Strategy and program development**
Prior to making a first investment, foundations should draft and adopt a local impact investment policy and/or guidelines that include details about a program's impact goals, financial objectives, risk mitigation/success management steps, and program governance. This consensus-building process involves multiple board committees and staff and, as a result, typically takes up to a year. Outside experts can provide foundations support as they develop a strategy that is reflective of their institutional goals and culture.

→ **Evaluating and structuring investments**
Opportunities may not be investable when they arrive at a foundation. In fact, investing when others will not – perhaps due to the "messiness" of the capital stack or the perceived riskiness of the deal – is modus operandi of many community foundations. That said, a willingness to tolerate more mess and risk does not dis-obligate a community foundation from dutifully assessing whether opportunities are right for investment. This process is known as due diligence and commonly involves a combination of internal staff, volunteers, and external advisors. A quality and thorough due diligence process will help foundation decision-makers determine not just whether to invest in an opportunity but at what terms.

→ **Documenting and closing investments**
Just before an investment is made, the negotiations between the parties become a written agreement detailing the terms. The process of properly documenting and closing investments can be technical and frequently includes attorneys or others experienced in the process of closing investments.

→ **Billing and reporting**
Foundations will have ongoing activities to maintain and safeguard their investments. These include sending invoices and collecting payments, monitoring and enforcing covenants to ensure impact and financial health, and summarizing performance and reporting to relevant stakeholders and committees. To support these activities, some foundations invest in technology solutions and/or advisors to automate or provide outsourced support.

→ **Other implementation supports**
Local impact investing foundations can also expect to spend time on program review and assessment, marketing and communications, and donor and community engagement.

Mobilizing Implementation Resources

To implement local impact investing programs, community foundations often muster an "all-hands-on-deck" mentality and enlist a combination of internal staff, external advisors, and volunteer labor from committee members or community partners.

Existing Staff Resources

With respect to internal staff, it is important to note that in many community foundations, local impact investing programs are staffed using a slice of many department resources – investments, accounting, program, donor services, executive leadership, etc. It is important to account for each department's contributions to the local impact investing program – e.g., capital raising, opportunity sourcing, committee support, community engagement, storytelling. Understanding these staff inputs enables leadership to make future resourcing decisions so as to sustain and grow local impact investing programs.

Nearly half of respondents, 44%, indicated that 1 full-time equivalent (40 hours/week) of staff time is fully committed to local impact investing. This encompasses instances where a single staff is responsible for all program operations and instances where a number of partial staff resources are involved in program operations. The remaining respondents, 56%, reported that local impact investing program operations are managed by <1 FTE.

Additional, External Resources

Internal staff efforts are frequently augmented by volunteers or professional external advisors. About a quarter of respondents leverage the skills and experience of impact investing committee members, board members, and trusted community partners to evaluate prospective investment opportunities. Though, it is not clear if these volunteers are supporting early internal investment screening or formal due diligence and underwriting.

Table 1: Common Contracted Professional Services

Activity	% Responses
Evaluation & Structuring	56%
Legal & Closing	56%
Portfolio Servicing & Reporting	22%
General Implementation Support	11%

Table 2: Number of Average Annual Transactions

# of Annual Transactions	% of Responses
0 – 1 Annual Transaction(s)	33%
2 – 4 Annual Transactions	56%
5 – 9 Annual Transactions	11%

Only two community foundations indicated that all local impact investing activities to-date have been covered exclusively by internal staff resources. In both instances, these community foundations have taken a co-investment approach to deploying dollars – allowing the institutions to "piggyback" off of a partner's underwriting, closing, and servicing capabilities. Generally, annual participation expenses are deducted directly from the interest earned on the investment.

Over half of the remaining respondents rely routinely on contracted consulting and advisory support. Most recurring local impact investing program expenses result from transaction services – e.g., due diligence and underwriting, legal, annual evaluation, servicing. Given this, it is reasonable to estimate annual deployment-related expenses based on the number of investments that will be made within a calendar year. Regardless of the local impact investing program size, nearly all respondents indicate that their organizations make fewer than five investments annually.

To succeed, local impact investing programs require adequate financial resources to cover the anticipated annual deployment activities. A quarter of respondents cover local impact investing program expenses through resources from the annual operating budget. Encouragingly, over half of respondents (56%) noted that they supplement operating budget resources with grants from donors, local businesses or outside organizations.

Generating Program Revenue

LOCUS recommends assuming that early program financial returns are insufficient to cover program costs. Instead, local impact investing, like grantmaking and community leadership, are supported through the foundation's operating budget.

Setting an Interest Rate

Like grantmaking, local impact investing offers foundations the opportunity to extend capital to partners and projects that will generate mission-aligned impact in communities. But unlike grantmaking, capital deployed as local impact investments is both recoverable and return-generating. One of the central benefits of local impact investing is that the practice offers the opportunity to receive return of and on capital.

Traditional investment paradigms rely on the notion of "risk-adjusted returns" – a concept that tethers the level of risk to the level of financial return. This principle is deeply incompatible with the goals and objectives that many community foundations have established for local impact investing programs where "riskiness" is assumed. For foundations creating local impact investing programs, decision-makers must be comfortable introducing a third element – community impact – to the risk and financial return conversations.

But many community foundations, including those that responded to the survey, expressed that their institutions struggle to identify reasonable return expectations and balance impact and interest rates. To manage this process, foundations can start by establishing a benchmark for the overall local impact investing program returns – commonly around 3%. Deal by deal, foundations have the opportunity to take a "temperature check" on how previous investments are contributing to the expected community impact and financial return expectations that have been established, and future investment terms (including interest rates) can be calibrated accordingly.

For example, a foundation may consider subsidizing the interest rate to an emerging microloan fund that specializes in lending to entrepreneurs of color while slightly increasing the potential interest rate to a large, established community development financial institution. In this scenario, the foundation is accommodating for investee capacity in such a way that acknowledges that the emergent loan fund may be a higher repayment risk but does not "penalize" the investee with a higher interest rate. Both investees can access capital resources but at terms that are optimal for an emergent organization and acceptable for an established organization.

Charging Donor Fees

Occasionally, though not a widely adopted practice among the respondents, some community foundations acknowledge that local impact investing programs are a professionalized, valuable service that warrants an additional fee structure. There are some community foundations, including one survey respondent, that pass-through investment costs to the participating donor investor. This is most often the case when an opportunity is sourced by or is of significant interest to a donor.

For More Thoughts

LOCUS believes that philanthropy should work alongside communities to grow economies that work for all. It is our mission to encourage the growth and improve the effectiveness of place-placed impact investing to advance vibrant, equitable communities and economies. We hope that this resource will support foundations as they advance their place-based impact investing practice. Other resources and field building materials are available at www.locusimpactinvesting.org.

Table 3: Community Foundation Resourcing Survey Responses

Focus Areas	Housing, food, small business	Housing, small business, fair financial products (consumer)	Housing, small business, community facilities, consumer credit, K-12	Housing, small business	Housing, food, small business, justice reform	Housing, broadband, small business	Housing, food, small business	Housing, small business, non-profit, cooperative ownership initiatives	Housing, food, small business, tech products
Portfolio	$2 MM	$3 MM	$6 MM	$2 MM	$10 MM	$2.2 MM	$15 MM	$24 MM	$2.5 MM
Yearly Investments	2 to 4	2 to 4	2 to 4	1 or none	1 or none	1 or none	2 to 4	2 to 4	5 to 9
Average Investment Size	More than $100K less than $500K	More than $100K less than $500K	More than $500K less than $1 MM	More than $500K less than $1 MM	More than $500K less than $1 MM	More than $100K less than $500K	More than $500K less than $1 MM	More than $1 MM	More than $100K less than $500K
FTE	0.5	<1	0.25	1	1	1	1	0.8	0.5
Volunteers	No	Yes, evaluate investments	Yes, evaluate investments, 2 hours a quarter	No	Yes, evaluate investments	No	No	No	No
Consultants	Yes, legal services, evaluate investments	No	Yes, billing and reporting, 1 hour a month	No	Yes, legal services, evaluate investments	No	Yes, evaluate investments, performance reporting, 2 hours a month	Yes, legal services, evaluate investments	Yes, general advice, 1 hour a week
Expenses (Budget %)	Unknown	3% (estimated)	1%	<1%	<1%	Unknown	Unknown	0.76%	<1%
Fees	Normal fees	Normal fees	Normal fees	Special fees	No fees	Normal fees	No fees	Normal fees	Normal fees
Method for Covering Expenses	Operating budget	Operating budget and grants from participating donors	Operating budget and board discretionary grant	Operating budget and grants from participating donors	Operating budget	Operating budget	Operating budget	Grants from participating donors	Operating budget and grants from businesses or organizations